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THE SOVIET ECONOMIC SYSTEM IN TRANSITION

STATINTL

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"Let us admit the case of the conservative: If we once start thinking no one can guarantee where we shall come out, except that many objects, ends and institutions are doomed."

John Dewey

In October 1961 Communists from all over the globe gathered in Moscow for the 22nd Party Congress. This ceremonial assembly was the crowning achievement of Khrushchev's party career. At the previous Party Congress in 1959 he had announced the final victory of socialism and the advent of a new historical stage of development, the all-out building of Communism. At the 22nd Congress he completed the process of ousting Stalin from his place in the pantheon of Party greats, and even from his resting place. He staked his own claim to a seat on the right hand of Lenin by promulgating the Party's twenty-year program, upon the completion of which the USSR would have arrived at or near the stage of full Communism.

Economic growth at a tumultuous pace was so well established under Socialism (after Stalin's errors had been corrected by Khrushchev) that a time table for the advent of Communism would be set by economic milestones. The first and most breathtaking, catching up with the US in

industrial production, was promised for 1970. After that, the satisfaction of all economic needs and desires, "all that a man could reasonably want," would be within the grasp of the bountifully productive Socialist economy. According to the Party program, food supply would double, there would be an apartment for each family, and services would be increasingly provided free of charge.

The contrast between the old man's illusions and the present economic conditions and prospects could hardly be more obvious. Since the 22nd Party Congress, agriculture has progressed so little that wheat, which was formerly exported, has been imported for the last three years. Soviet GNP has not gained on US GNP and may even have lost a little. Industrial production has gained very little on US production. Urban housing has barely kept up with urban population. Throughout the land the great slogan of catching up with the US in 1970 is heard no longer.

More chilling to Party hopes than these economic developments is an apparent loss of faith in the economic system itself. In 1961 the system of central administrative direction of the economy under the tight rein and driving whip of the Communist Party was unquestioned -- at least publicly. Since then, first academicians, then economic administrators and now the highest Party leaders have openly acknowledged the grave deficiencies of the command economy.

Was the promise of the 21st and 22nd Party Congresses correct; that the construction of Socialism was finally completed and the material base for Communism laid? Subsequent experience suggests that the promise

was not quite true. State ownership is accomplished; industrial capacity has been built; but ~~this~~ capacity still provides little for Soviet consumers, and more important, the economic organization, whatever its past triumphs, is now found wanting.

Premier Kosygin's speech to the Party Plenum in September 1965 proposed a series of reforms in economic organization, the inspiration for which was not Karl Marx or Lenin and certainly not Stalin. Its intellectual sources were the late Oscar Lange, the experience of Yugoslavia, and the writings of the liberal faction of the Soviet economic profession. The proposals include the first timid steps away from tight central direction of the economy and toward a market socialism. Many Westerners anticipated much bolder steps and were disappointed at the vague and partial program outlined by Kosygin. The boldness of the step, however, is much less significant than the direction. It is a step that will be very difficult to stop or reverse. The future course and ultimate destination of the reform, however, is far from clear.

Kosygin's proposals follow from a complex of developments -- economic, intellectual, and ideological -- which, starting slowly after the death of Stalin, have unfolded with astonishing speed in the last few years. Although the depth and ^{the} diversity of this evolution argue for its irreversibility, they do not provide a chart of its future directions. The survey that follows will review the highlights of the economic changes of the last 10 years as they bear on future possibilities. These are:

1. The slowdown in economic growth;
2. The revolution in economic thought;
3. The developments in economic organization.

I. The Slowdown in Economic Growth

The slowdown of economic growth in the USSR is now a well-known story. The recent State Department press release, USSR Falters in Economic Growth Race with the US, sets forth the main measures of Soviet growth. These measures show that in 1961-65 as compared with 1956-60, the average annual rate of growth of GNP fell from 6 percent to 4 percent; the growth of industrial production dropped from 8 percent to 6 percent, and that of agricultural production from ~~X~~^{3 1/2} percent to 2 percent. An even more dramatic change would appear, ~~especially~~^{both} for ~~industry and agriculture~~^{and agriculture}, if growth were measured from 1950 instead of 1955. Other measures confirm and extend the story. According to Soviet statistics, the average annual growth of state fixed investment dropped from 12 percent in 1950-59 to 8 percent in 1960-64; the growth of over-all investment (that is, including private and kolkhoz investment) declined from 13 percent to 6 percent. The average annual rate of increase in consumption was 6.8 percent in 1950-59, but 3.9 percent in 1960-64.*

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* See the paper by [REDACTED] in this volume.

Soviet announced statistics of national income and industrial production show much the same slowdown in growth as the Western calculations, and Soviet press comment has explicitly admitted the retardation. Premier Kosygin described it in these words in his speech at the Party Plenum in September 1965:

"It should be noted that in the past few years there has been a certain decline in national income and industrial output per ruble of fixed production assets. The rate of growth of labor productivity in industry, which is also an important index of the effectiveness of social production, has slowed down somewhat in recent years."

The fact of the slowdown is clear, but the explanation is not. The sudden retardation does not correlate with any observable events that can serve as plausible causes, except in the important case of agriculture. In agriculture the one-time gain from the new lands added to the growth between 1954 and 1956. A similar short term gain resulted from the programs to boost the production of corn, milk and meat. Following 1956 the declining yields in the new lands contributed to the slowdown.

Changes in inputs other than land do not account for the slowdown. Manhours of labor have grown somewhat more slowly, but capital has not. Rather, the key variable has been productivity. The production slowdown is reflected in declining rates of growth of the productivity of both labor and capital. Thus an index of factor productivity (labor and capital combined) would show a decline.* This trend is in contrast

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* See papers by [REDACTED] in this volume.

to Western Europe as a whole, where the rate of growth has not slowed noticeably, and where in most countries both labor and capital productivity have continued to grow at a steady pace.*

The growth in factor productivity is supposed to reflect the impact of new technology, improvement in management, and the quality of labor, among other things. The Russians have alluded to the first two of these as causes of the slowdown. Konygin, for example, said:

"At present industry has entered a period of development when its rate of growth will be determined to an ever-increasing degree by technical progress, the swiftest possible application of scientific achievements in production. Meanwhile, we have substantial shortcomings in this matter.....The forms of industrial management, planning and incentive now in effect no longer conform to present-day technical-economic conditions and to the level of development of production forces."

A Western writer has found that the third was also a contributing factor.**

The slowdown in factor productivity has gone on too long to be merely temporary. It is a striking development. It blunts the edge of the one sharp tool of Soviet economic planning, the high rate of savings and investment. The long established priority and faster growth of investment over consumption once seemed able to go on forever, and as long as new technological opportunities were still available, rapid growth seemed assured. Now, however, the conditions for growth have changed.

Most observers would have agreed that the rate of growth of the Soviet economy must eventually slow. But the suddenness of the change,

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* See paper by [redacted] in this volume.
** See paper by [redacted] in this volume.

like a horse going lame, surprised many, including this writer. Two important developments in the late 1950's, the surge of defense expenditures and the shortening of the work week from 46 to 41 hours, surely contributed to the timing and magnitude of the slowdown in growth and in productivity. The direct effect was a loss of labor and capital inputs into the civilian economy. Indirectly, by pre-empting for the advanced weapons programs the most efficient research and development resources -- men, materials and equipment -- the defense effort must also have contributed to the drop in the effectiveness of new investment. However, this still leaves unanswered the questions of why the system was unable to adjust to these developments and why the growth of factor productivity continued to be slow through 1965.

A critical factor seems to lie in the ability of the systems to cope with technological complexity and change. In The Economics of Soviet Planning, Professor Bergson* presents a comparison of Soviet and US net national product in 1960 in both dollar prices and ruble prices and of the respective capital and labor inputs. Soviet net national product per unit of input ranges from two-fifths to two-thirds of that of the US according to various alternative calculations. This large difference suggests a still massive technological lag in the USSR, a suggestion that is confirmed by Western observations and by Soviet reporting on the technological backwardness of the chemical industry (e.g., synthetic fibers), petroleum refining, highway transportation,

* Abram Bergson, The Economics of Soviet Planning, Yale University Press, New Haven, 1964, p. 342.

consumer durables, animal husbandry, and many other activities.

Investment opportunities with high net yields, of the kind that Western Europe and Japan have been reaping lately, are still available in production to the USSR. But the growth of output has slowed to rates now less than in the US. The difficulties in the current period thus apparently stem from an inability to take advantage of new technology. This situation contrasts sharply with the impressive results of the wholesale adoption of new techniques in the thirties. But whether the nature or the complexity of new technology have changed, or whether the poor recent performance was inherent in the system is still arguable.

There is much to be said for Professor Rutter's thesis*, that Soviet policy has been to concentrate on those products for which the largest reduction in costs could be expected. These happened to be steel, fuel, electric power and a few standard machinery items. The slowdown can thus be viewed in the first instance as the result of running out of easy investment opportunities. The most dramatic illustration of this is the shift of investment to agriculture, where returns are small. The planners have long hesitated to invest in irrigation and drainage of swamps, because these investments are very expensive. Now urgent need is forcing the shift. Fertilizers, plastics, and synthetic fibers also represent heavy investments for still doubtful gains. Khrushchev vigorously sold the program for new chemicals with hypothetical and

* G. Warren Rutter, "On Measuring Economic Growth," Journal of Political Economy, February 1967.

unrealistic cost figures. In exactly the same way, the great success in steel production was difficult to follow up with thin cold rolled sheet capacity, even when the need became obvious. More than any other system in history the Soviet economy has depended for its growth on economies of scale, for the very good reason that versatility is its weakest point. One apparent, but illusory, advantage of being behind is that an underdeveloped economy can concentrate on selected sectors in the plausible belief that large capacities will ultimately be necessary; other sectors, it is argued, can come later and can also gain from concentration. The Soviet development strategy has been one of selecting priorities on grounds of production cost rather than of utility. However, a natural consequence of doing easy things first is that hard things eventually come due.

In discussing the recent economic developments, Soviet economists accept without question the past development strategy, and use it to justify the economic system that went with it. They have adopted the argument that centralized planning and control was necessary and desirable at the earlier stage of rapid industrialization, but that the economy has now become too large and complex to be planned in detail at the center. Present conditions call for some decentralization, as in the current reforms. By implication, the complexity of the economy accounts for the slowdown. This argument is only half right at best. The Russian economy was too complex for central planning right from the start of the Five Year plans. These plans were fulfilled, if at all, only by the high priority sectors, mainly heavy industry. But, by Stalin's simple scale of priorities, this was success enough.

The priorities and wants of the present leaders have multiplied prodigally. Agriculture of necessity has become high priority and a large claimant on investment resources. The seriousness of the housing shortage is recognized. With respect to clothing and shoes, the leaders are striving not only for greater quantities, but also for acceptable quality. Finally, consumer durables, even automobiles, are being promised and scheduled for large increases in the new Five Year Plan.

These expanded wants create a much more difficult managerial problem than Stalin's singleminded approach. There are no entrepreneurs in the USSR, none working for the state at any rate. Or rather, there is only one, the leadership. When the leadership initiates more activities than it can control and manage, management and control drift inexorably into the hands of an amorphous bureaucracy. To say that the economy has become more diverse, complicated and specialized is only to say that the leaders now want more activities than they can manage. In particular they now want a variety of finished goods as well as intermediate goods.

The expansion of the Soviet regime's wants and priorities is a development that was inherent in its strategy from the beginning. The rationale of the industrialization drive of the thirties and again in the early postwar period was that the building of heavy industry was a precondition for and the quickest way to obtain a profusion of

consumer goods. The desirability of this strategy of development and of the organization that implemented it must be judged, not by its success in achieving its immediate objective of building a heavy industry capacity, but by the success in reaching its ultimate objective of producing consumer goods.

The Soviet economy's poor performance in the production of consumer goods is well known. It is also clear that the Soviet notion that a massive intermediate and capital goods capacity will automatically produce a finished consumer goods capacity still remains to be vindicated. To be sure, the right kind of intermediates and capital goods capacity could produce plant and equipment for consumer goods, but the present leaders are finding that the capacity they inherited from yesterday's planners is not the right kind. The machine building industry has still not been able to produce a respectable line of agricultural machines. When the time came to build plants for plastics and synthetic fibers, Soviet industry had neither the know-how, designs, equipment or materials for the job. The Soviet-built plants have experienced inordinate delays in construction and in achieving capacity output after completion. The growth of these modern chemicals has depended in large part on imported plants. The machine tool industry, which has outproduced all others in the world in number of machine tools, is not able to equip a modern automobile plant. In order to meet the new Five Year Plan for automobiles, the Soviet leaders have turned to Fiat in Italy to provide an automobile design and

a complete manufacturing plant. Other consumer durables reflect the same problem -- the lack of versatility and flexibility of Soviet heavy industry, which was primarily designed to reproduce itself.

The ability of Soviet industry to produce a variety of apparently effective advanced weapons and space equipment is an exception which proves a more general rule: that what success Soviet industrial management has had has been due to concentration on a few high priority fields.

Another familiar characteristic of Soviet management is emphasis of quantity at the expense of quality. A consequence of this emphasis is that the seemingly enormous stock of capital requires large amounts of replacement capital, repair and maintenance service, and spare parts. Instead of being a versatile productive machine ready to turn out a stream of consumer goods, the Soviet economy is an insatiable consumer of resources. Thus, the large number of tractors and agricultural machines reported idle and awaiting repair testifies to the frequency of breakdown as well as to the shortage of spare parts. Another statistic widely cited in the Soviet press is that repair work occupies 20 percent of the workers in machine building and metalworking as well as one-third of the machine tools. *To a considerable degree* the CPSU has sold its birthright of saving for a mess of intermediate pottage.

An extended research could compile a mountain of inefficiencies and wastes in the Soviet economy. The brief survey here is intended

only to give the flavor, not the quantitative measure of the disequilibrium. My purpose is only to argue that no simple solution is open to the Soviet leadership. Kossygin and Brezhnev may identify and correct each of Khrushchev's mistakes, but the list of mistakes still remaining to be corrected will be no shorter. The command system has no recourse but to give commands, and it is as clear as can be that no commands can cure the economic troubles of the USSR.

How serious is it for the CPSU to accept the slower growth and give up the hope of catching the US or even Western Europe in per capita production? The Party's platform for the people has always been the future: indeed, the Party justified the sacrifice of well being, freedom and even life in the present as the necessary price of Utopia in the future. It is hard to see how the Party could give up its central ambitions of success for its system, welfare for the people, and world power for itself. Reconciliation with a moderate growth and a pale and lagging imitation of Western life could be bought by a forgetting and forgiving by both the Party and the people that is hard to conceive. What role the Party's economic program plays Khrushchev explicitly revealed at the 22nd Party Congress:

The Party's third program heralds the coming of a period in which all the difficulties and privations which the Soviet people have endured for the sake of their great cause will be made good a hundredfold.

The Party surely will not accept economic stagnation without a fiercer struggle or without attempting to substitute some other motive goal for that of catching up with the West. Any alternative goal -- such as rapid growth in standard of living -- is likely to be no easier to attain than the restoration of rapid over-all growth. The dilemma for the Party is that the causes of the slowdown and the Party's tangible *raison d'être* are rooted equally deep in the system.

II. The Revolution in Economic Thought

Stalin, living, lay like a dense smog over Russia, smothering the people, their minds and any words other than his own imbecilic slogans. His death was a release from suffocation for the Party, and the clearing wind of his passing let a few rays of hope gleam even for ordinary people. Gradually men began to do what men do naturally, to think, to ask what they are after, to use their brains to tackle problems. The Party leaders themselves were no less eager to make fresh beginnings, to forge new tools and new ideas, although the ideological goals remained the same. In due time economists were cautiously invited into the problem-solving process. The assignments were narrowly prescribed -- the effectiveness of investment and the basis for pricing, but the process of thought, once started, leads from one thing to another. Under a disguise of mathematics those interested in economic problems soon were exploring far beyond the boundaries that the Party had marked for their inquiry.

The image adopted by the Russians for Stalinism and its aftermath was the "freeze" and the "thaw". But the upwelling of economic thought over the last ten years testifies that minds were not frozen, even if tongues were. As one Western writer has shown, Soviet economists in only a few years have recreated all of the essential features of Western economic theory.* With the ^{ist}Marxist labor theory of value as the point of departure, this is an impressive leap forward.

The labor theory of value states that the price of a product (in the long-run) should be equal to the labor costs of producing it including, of course, the labor costs of the material input and of the capital consumed. This begs the questions of how wages are set. The Soviets, however, have long since recognized the usefulness of supply and demand for wage setting. The elements missing from the labor theory of value that are crippling to analysis of the Soviet economy are:

1. Charges on capital and land -- i.e., interest and rent.
2. The role of demand in pricing and hence in the guidance of production.
3. The pivotal function of profits in transforming the price signals into compelling incentives for producers.

All three of the elements are now openly recognized and discussed in Soviet economic literature. Furthermore, they are now also explicitly guiding organizational proposals. All three elements were highlighted in Korygin's speech last September on improving the economic system.**

* Robert W. Campbell, Slavic Review, October 1961, pp. 402-11.

** Pravda, 2 September 1960.

The stage of development of economic thought that lay behind Kozysin's creed was arrived at by way of many bitter intellectual and ideological battles. When Kantorovich's path-breaking presentation of linear programming, The Best Use of Economic Resources, was published in 1959, it was very unfavorably reviewed by ^{two leading conservative economists} Boyarskiy and Kats. Kantorovich recommended the use of a set of "shadow prices" that would reflect the scarcity of products relative to demand. Reviewers correctly pointed out that this approach directly contradicted the labor theory of value. The argument spluttered on for years until the piling up of unsaleable inventories of consumer goods made the discussion silly. Now Soviet writers talk freely about demand. Even the notions of utility and marginal utility are mentioned* though certainly not widely accepted.

The ideas of interest and rent have slowly but persistently crept into the discussions of effectiveness of investment. The impetus for this was simply the obvious waste of capital goods going on all around. Liberman's proposal to use the ratio of profit to capital stock as an indicator of enterprise performance was intended to promote economy in the use of capital. Other economists simply advocated an interest charge, a point of view that met determined resistance. Speaking in 1964 to the conference on the use of mathematics in economics, the Dean of Soviet economists, Strumilin, still held out against the use of such a capitalistic device.

*For example, A.I. Vaynshteyn at the conference on the use of mathematics in economics, Voprosy ekonomiki, No. 2, 1964, p. 71.

Profit was dramatically thrust into public discussion by Liberman in 1962. By then the advantages of profit incentives were so generally accepted that the conservative school confined its objections to the use of profit as the only success indicator. The conservatives argued that it should be only one of many, and they said in particular that fulfillment of the output plans must still be required; otherwise, there would be no plan. This is certainly true. If profit and prices alone guide production, then planning as the Soviets know it is out of business.

Although the advocates of reform devote endless pages to proving that profit, demand and a change on capital are not inconsistent with Marxist theory or with Lenin's views, it is plain to see that the inspiration for all the new ideas is Western economic theory and practice. The objections of the conservatives center on this point. No Soviet writer, up to now, has dared to assemble the separate elements into a unified theory, for such a theory would simply be the marginal economic analysis that is familiar in the West. By talking of each element separately in the context of the present system of planning, the reformers disguise the fatal similarity to capitalist thought.

A nearly disastrous split between two schools of reformers delayed the influence of the reform school for several years. The two schools were (1) the advocates of improving central planning through mathematical methods implemented by computers, and (2) the

decentralizers, who wished to reduce the scope and detail of planning and to rely more on profit incentives and initiative at the enterprise level. Older economists, like Brezhnev, wrote as if both approaches were necessary, but the issue grew sharper as the younger cyberneticists, e.g., Glushkov, seemed to argue that decentralization was unnecessary since in a few years computers would be able to solve economic problems much more efficiently than enterprise managers.

The conservatives, or retrogrades, as the reformers affectionately called them, skillfully exploited the split by supporting mathematical methods while opposing the use of profit as the primary indicator in the mathematical formulations. The controversy broke into the open in the spring and summer of 1964 in a series of articles published in Liternurnaya gazeta. In these articles the conservatives proposed that mathematics be used to solve particular problems such as transportation scheduling, and that computers be used simply for calculation and accounting. They denounced profit. The reformers ~~vehemently~~ shrilly defended both mathematical planning and profit.

As time passed, the complexity of the practical problems in comprehensive mathematical planning became clearer and clearer. An input-output table for the year 1965 was assembled, but the effort revealed how inadequate was the existing information reporting system. Moreover, the result was far too aggregative for use in detailed planning.

a mathematical economist

In 1963 ~~he~~ pointed out the impossibility of planning and accounting for every nut and every bolt in every province.* Mathematical economists began to speak in terms of decades instead of years to bring planning under the wing of mathematics. *One of the leaders of the mathematical school,* Aganbegyan, was quoted in 1964 as follows:

"The problems of the application of electronic computers in planning and in economics are being studied in Moscow, in Kiev, at our organization in Novosibirsk and in other laboratories in the Soviet Union. However, these efforts are still insignificant, simply insignificant."**

Finally, computers were being improved and made available much more slowly than it was hoped.

The ranks of reform economists were finally closed in 1964 at the conference on mathematical economics in Moscow. The issue was decided in favor of merging the use of mathematics with decentralization. Although a few conservatives fought a half-hearted rear-guard action, Kantorovich -- the inventor of linear programming and the next famous of the Soviet mathematical economists -- made the key speech, in which he endorsed economic levers, reduced planning and decentralization. He called for a greater degree of "...the replacement of imperative indications with the utilization of more flexible and sometimes more effective economic levers of regulation." And he said:

Birman, I.,
* *Iskonnicheskaya gazeta*, 30 March 1963.
** *Literaturnaya gazeta*, 14 May 1964.

"At the same time the economic evaluations obtained in the compilation of the general centralized plan with the aid of mathematical optimization make it possible for efficient decentralized decisions to be made along with an achievement of coordination between the profitability of enterprises and national economic profitability.....

"The principle of unified centralized planning of the main directions of economic development that has fully proven itself will be preserved in effective combination with considerable freedom and initiative at the local level...."*

Accompanying the positive theorizing has been a rising clamor of criticism of things as they are. The testimony of enterprise managers and other local economic officials has provided an overwhelming list of bad practices and performances as regards quality or usefulness of product, allocations of materials, the effectiveness of investment, automation plans, design of equipment and the work of design bureaus, the rules governing hiring of different kinds of labor (e.g., the ratio of clericals to engineers), the inappropriateness of incentives and prices. The recommendations are various and usually parochially narrow. They almost always call for reform of central bureaucracies or reduction of interference from above.

As things stand now, Marxist economic theory is being increasingly bypassed, and all new initiatives derive from Western theory and practice. The only question is how far and how fast market processes will be adopted. The current debate is between the use of markets to make the plan work better ^{and} ~~or~~ the use of markets to replace the plan. Although ^{**} Sukharevsky stated the official position to be the former, his emphatic

* Reported in Voprosy Ekonomiki, No. 9, 1964, pp. 81-2; underlining by the writer.

** *Deputy Chairman of the State Committee on Labor and Wages.*

defense of the plan bespoke a bitter and unresolved conflict raging behind the scenes, and his conclusion was belied by his own arguments that the scope and detail of the plan could and should be reduced.*

The comprehensive central plan is the last defense of the Party's economic ideology. The skeptics will ask: if the plan can be replaced, what was the use of adopting it in the first place? Nevertheless, if the current partial reforms do not work, the only advice that will be advanced will be to move further in the direction of market socialism. No other body of ^{reform} thought has any standing in the Soviet economic profession.

III. The Developments in Economic Organization

On September 27, 1965, Premier Kosygin delivered his remarkable speech to the Central Committee on reorganizing the economy. A large part of the speech dealt with a change from the sovnarkhoz, or territorial organization, to a ministerial form. The interesting proposals, however, dealt with incentives and increased freedom for enterprises. As such, they constituted, along with the experiments of 1964-65, the first official move away from the principle of centralized state planning.

All of Khrushchev's many reorganizations were simply a shuffling of boxes, the replacement of one organ of command with another. A

* Voprosy Ekonomiki, No. 10, 1965, pp. 14-31.

particular case in point was the substitution of regional sovnarkhozes for the industrial ministries in 1957. The reversal of Khrushchev's reform by Kosygin testifies to its insignificance. Merely changing the line of command did not change the basic nature of the command economy, nor correct its deficiencies. Kosygin's other proposals, in contrast, call upon an entirely different principle, the principle of voluntary choice and market trading, to govern activities that were formerly planned.

As a liberal, decentralizing proposal, the newest Soviet scheme is neither the first nor the most radical in the European Communist countries. It is less liberal than the Czech proposals of 1964 and pales in significance when compared with the conscious and comprehensive attempt of the Yugoslavs to use market trading and decentralized controls. Indeed, the timidity of the latest Soviet reform surprised many Western observers, who had been led to believe by the fairly radical Soviet academic discussion that a dramatic step toward market socialism would be taken. The step that actually was taken is an attempt to have both systems, to season central planning with pinches of marketing and profiteering. The direction of the reform is significant, but its scope is not as yet.

Specifically, Kosygin proposed:

- (1) A percentage charge on invested capital to be paid by enterprises, that is, an interest rate.
- (2) A reduction in the number of obligatory targets for the

enterprises, the three dozen or so old targets are to be replaced by eight or nine. Of these, the controlling ones seem to be the plan for output of the main commodities, the over-all wage fund, total value of sales, and profit. The latter two replace the ~~previous plans~~ ^{targets} for cost reduction and ^{for} the ill-famed gross value of output as determinants of the bonuses for managers. The incentives and freedom of action of enterprises are to be reinforced by leaving more of the profit in specially created enterprise funds for bonuses, cultural expenditures and investment.

Direct contracting with retail outlets or other customers was mentioned only briefly by Kosygin. The government had already announced at the beginning of the year, however, that the experiment in direct contracting being conducted in a few pilot plants would be extended to some 400 plants in light industry.

The timing, pace, and scope of the reform was left vague in Kosygin's speech, and implementation has been cautious. A statute of 20 October 1965 on the rights of industrial enterprises allowed managers more freedom of action particularly as regards staffing patterns and wage rates. A series of methodological instructions issued in February and March 1966 spelled out the timing and method for transferring enterprises to the new system ^{and the results} for the payment of bonuses to workers and management personnel and for ~~the~~ establishment and use of the enterprise investment fund. According to the current schedule, the transfer of

all industrial enterprises to the new system is to be completed in 196 . These actions remove any doubt as to the seriousness of the regime's intentions about the reform.

The theme of these reforms, faint but consistent, is market socialism. But along with the new, Kosygin valiantly affirmed the old. He defended the planning of production and denounced "the uncontrolled mechanism of the market." Although profits, interest and a bit of marketing are included in the reforms, the output of principal products of the enterprise will still be planned. This unequivocal ambivalence probably wipes out any hope of success for this round of reforms.

Economic institutions are like teeth. If the old teeth get worn, loose, and decayed, they can be replaced by a shiny, new functional set. But the new ones can't go in until the old ones come out. Similarly, two different institutions cannot perform the same function at the same time and enterprises cannot simultaneously produce the mix of output that the market wants and the one that planners want.

In the concrete reality of the Soviet system, the salutary, or even cosmetic, effect of a petting of ^{market} trading is unlikely to be realized. To be beneficial, markets require flexible prices, an over-all reduction of excess demand, and alternative sources of supply. The regime is carrying out a reform of prices to reflect cost of production, but they are not to be flexible nor will they reflect the influence of demand. Likewise, there is no indication that the Party leaders contemplate reducing consumer purchasing power and investment plans.

The economic effect of the reforms can be forecast in advance. Because the reforms are so circumscribed, their net effect cannot be large, either for good or for bad, but their nature is such that there are likely to be both kinds of effects. On the one hand, the positive incentives may lead to improved efficiency at some enterprises, and direct contracting may result in smaller stocks of unsold consumer goods and to that extent greater consumer satisfaction. On the other hand, the same incentives if they begin to be effective may lead to output mixes counter to the plan, reshuffling of supplies as between enterprises, refusal to accept unwanted equipment, layoffs of workers, and unemployed capacity. Some enterprises may make unexpectedly large profits and others unexpected losses. None of these latter effects would be welcome to the Party and the bureaucracy. In the wasteland of Soviet management, any effective incentives to efficiency would produce widespread and pervasive shifting of resources, distribution channels, and output mixes, with considerable short-run dislocations. It can be assumed that bureaucratic interference to counteract these symptoms will appear almost as soon as the symptoms.

In short, the new system cannot operate as long as the old is on the job in full strength. The new ministries occupy a key position, and the other bureaus of planning, supply and allocation at national and republican levels still exist, with jobs, tradition, and a way of life to defend. An example of this conservatism was reported last

year. A consignment of goods shipped by the Mayak garment firm to fulfill a direct contract with a particular customer was intercepted by the wholesale trade organization and sent to a different retail outlet.

The conclusion of this argument is that this round of reforms will not accelerate growth, and that neither the leadership, the people, nor the intellectual elite will be satisfied by the results. The important question is, what will they do then?

IV. Prospects: Evolution or Revolution?

The history of the Soviet economy since the death of Stalin has been one of recurring reforms and reorganizations. Kosygin's reform is not likely to be the last one. The basic deficiencies of central planning have not been touched, and the dissatisfaction of the intellectuals is deep-rooted. One prognosis put forward by a number of Western observers is an evolutionary development toward market socialism. This view argues that the current cautious reforms will be followed by others going farther in the same direction. Thus, as tensions arise between the new system and the old, the leadership will progressively increase the flexibility of the plan, of prices, and of the freedom of the enterprise until at last the plan disappears and markets take over.

There is much to be said against this view. It is difficult to picture the Party and the planners presiding over the dissolution of

planning. Secondly, a market system is a tricky thing to manage, even when the leadership believes in it. Such a leadership necessarily would have to put up with a great deal of messiness. The difficulties that the Russians observe in Yugoslavia must give them pause -- price instability, inflation followed by spasms of price reform and devaluation, monopoly profits in some areas and heavy subsidies in others, and investments wasted on ice cream parlors and football fields. The "chaos of the market," which Soviet writers all seem to fear, is well exemplified there. And finally, neither the ~~centralized~~ economic bureaucracy nor the local Party apparatus is likely to accede gracefully to its own withering away.

Evolution toward an intermediate position that would still preserve the essentials of planning also is conceivable. For example, a variation on market socialism was described in 1957 by Oscar Lange in his essay On the Economic Theory of Socialism and has been revived in recent Western discussion. Instead of allowing prices to guide production, the planners might vary prices to equate demand to the planned production mix. Excise taxes and subsidies would help keep enterprise profits to a reasonable norm. Or, alternatively, if short-run equilibrium prices were thought to be too fidgety, long-run "rational" prices could be calculated by computers. A few tentative comments on the realism of these suggestions may be hazarded:

1. People rational enough to apply the rules of Western equilibrium analysis so methodically might also begin to question the rationality of planning a product mix in detail.

2. The notion of bureaucrats accepting the criterion of economic efficiency at the expense of "right" results, "fair" prices, and "justice" postulates a species of homo not yet created.

3. Any suggestion that sensible prices can be introduced into a country where apartment rents are one-third of cost and bread is priced cheap enough to feed to pigs is breathtaking.

Despite these doubts about gradual evolution, I am inclined to believe that liberal reform in the USSR (and ⁱⁿ the Eastern European Communist countries ^{as well}) is past the point of no return. The economic performance of the present system presents the leaders with a choice of some kind of drastic reform of the system or of falling farther and farther behind Western Europe in productivity and standard of living. Agriculture illustrates the precarious nature of the present course of gradualism and temporizing. The newly announced Five Year Plan projects a doubling of investment in agriculture in 1966-70, as compared with 1961-65. This follows on the heels of a 57 percent increase in the period 1961-65.* The planned gain in output is 25 percent,** but the actual gain may be nearer to the 12 percent gain of the past 5 years.*** A sector as large as agriculture where investment is growing at 14 percent a year, and output is increasing only at 3 to 4 percent a year can contribute little to the goal of achieving pure Communism by 1990. Investment in agriculture will be growing rapidly as a share of total

* As compared to 1956-60.

** Average annual 1966-70 over average annual 1961-65.

*** Average annual 1961-65 over average annual 1956-60.

investment, which is ~~planned to grow~~ ^{planned to grow} at only 3½ percent a year, and of national income, which is to grow at 7 percent a year. Thus the most rapidly growing investment allocation is being poured into a sector where investment brings the smallest returns.

The argument that future reforms will be liberal in inspiration rests on the fact that no other kind of reform proposals now have any status. A powerful conservative opposition still exists, but it has nothing to offer but tinkering with the present system. Whenever the government has economic difficulties and seeks expert advice, the advice will be to liberalize further.

If, as argued above, evolutionary reform away from a command economy to its only known alternative, a market economy, is unlikely, then Soviet history provides us with another possible road to reform. The only significant changes achieved in the Soviet period, and I do not count Khrushchev's or Kosygin's economic reforms as significant, were revolutionary changes -- war communism, the N.P., the first Five Year Plan, and collectivization ^{of agriculture}. They were radical and even violent responses to crises. And thus they were in accord with a cardinal point of Marxist ideology that the old must be swept away to make way for the new.

Indeed, all of Soviet history has been merely a history of crises, as others have pointed out. The only two significant changes in other Communist countries were also sweeping, spasmodic and sudden -- the

dismantling of the collective farms in Poland and the decentralization of control over industry in Yugoslavia. It is no coincidence that both these steps were taken at a time of political crisis. As a result of its expulsion from the Soviet Bloc two years before, Yugoslavia in 1950 was in a state of growing uncertainty over the future. In Poland, in 1956, de-Stalinization and the Poznan riots had uncovered the weakness of the regime. Real change was possible in these comparatively fluid situations. Even so, the measures taken were limited in scope, and the subsequent restoration of political and social stability postponed further change.

The cautious moves toward economic reform that were made in Eastern Europe out of concern over a slowdown in economic growth had little effect. The programs undertaken in Poland and Czechoslovakia after the slowdown in the mid-1950's simply petered out in the late 1950's, leaving the impression that they had done more harm than good, and little of either. The "new economic model" of Czechoslovakia, the most widely publicized of the current programs, is typical of the reform movement in Eastern Europe. The operating autonomy extended to enterprises in principle in the "new economic model" is largely illusory, inasmuch as the state has retained direct control either in law or in fact over most enterprise decisions. Although there is much talk about the "market mechanism," it is evident that both state and Party retain -- and value -- the right to intervene at will in all economic decisions.

In the USSR the state of approved thinking currently is that the market is to help fulfill the Plan, not to replace the Plan. In the next round of discussion, or the round after that, the weight of opinion may shift to the latter alternative. When Soviet economists arrive at this conclusion, they will still be behind their counterparts in Eastern Europe. Several of these in recent private discussions with Western economists have brushed off the current reforms in Eastern Europe and have said simply, "the plan must go."

Whether economic conditions will become so critical in the USSR as to lead the Party, or a faction of the Party or a non-Party group, to dismantle the economic administration, is hazardous to predict. If growth rates and performance continue more or less as at present, the leadership may muddle along with the present system for some time to come. But if growth rates continue to decelerate, the pressure for further reform will build up again. The contention of this paper is that the evolutionary approach will not work any significant improvement, that reforms must radically sweep out old institutions before new ones can be built. Reforms need not be economy-wide. They might touch some sectors and not others, as the RFP and the Yugoslav reforms did. The most needy, and at the same time most unlikely, candidate for sweeping reform is agriculture. Here the ideological barriers and the Party guilt complex are the strongest, but here the need also is

the greatest. Yet no reform short of decollectivization and a substantial return to private agriculture offers much hope of improvement.

The Soviet leaders are placing their hopes on gradualism. The prognosis of this paper is that it will fail. The text for this prognosis comes from Oscar Lange. Near the end of his classic paper, On the Economic Theory of Socialism, he considered whether it would be better to make the transition from capitalism to market socialism gradually, step by step, or all at once. He concluded that a sweeping, once-and-for-all change was preferable; otherwise, the forces of entrenched greed would sabotage the change. This argument applies as well to ^{a centrally} administered economy as to a capitalist one.